

## Internal Revenue Service

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PLR-129017-08

Date:

October 23, 2008

### LEGEND:

Authority =

Association =

State =

Statute A =

Statute B =

Trust =

Code =

Plan =

State Retirement System =

Dear :

This is in response to a letter dated June 23, 2008, and subsequent correspondence submitted by Authority, requesting a ruling that income of a certain trust is excludable from gross income pursuant to section 115(1) of the Code.

## FACTS

Authority was initially established under a joint powers agreement with Association, but it is now a separate joint powers authority created under State Statute A. As such, Authority is a public agency separate and distinct from Association pursuant to State Statute A. The purpose of Authority is to operate a professional, general and directors/officers liability self-insurance program for State county hospitals and hospital districts. The membership of Authority is comprised of various healthcare districts and hospitals in State, which participate in Authority pursuant to State Statute B.

Authority is governed by Articles of Incorporation and Bylaws. Pursuant to its Bylaws, Authority's management is comprised of a multi-member council elected by its Members. Authority has employees and officers who carry out the organization's managerial and administrative duties.

Authority intends to establish the Trust to fund its retiree health benefits liabilities for its employees. Authority provides these benefits under the Plan, which subscribes to the State Retirement System. State Retirement System contracts with certain medical insurers to provide benefits under the Plan.

According to the information provided, the Plan provides only insured health benefits. There are no self-insured benefits or reimbursement accounts. The Plan is administered by Authority with the exception of claims processing, which is handled by State Retirement System and participating medical insurers.

Eligibility and costs of benefits vary based on hire date, years of service upon retirement, and whether the retiree or beneficiary is Medicare-eligible. Authority's liability for the cost of benefits depends on the retiree's years of service. Authority represents that there is no cash-out of any amounts paid for the Plan benefits and no conversion of sick or vacation days to post-retirement health benefits. Agency also represents that retiree benefits may not be paid by pre-tax salary reduction.

Domestic partners may be beneficiaries under the plan. Authority has represented that in administering the Plan, Authority will make reasonable efforts to identify domestic partners who do not qualify as dependents (under section 152 of the Code) of retirees who participate in the Plan. The value of coverage under the Plan for

domestic partners will be included in the gross income of retirees to the extent the premiums are paid for by pre-tax employer contributions.

The Trust will receive funding through contributions and income earned on its investments. Authority represents under penalty of perjury that the Trust income will be solely used for the benefit of Authority's employees. As such, Authority represents that none of its members nor any organization that is not a state, a political subdivision of a state or an entity the income of which is excluded under section 115(1) of the Code will benefit from the operation of the Trust. Authority has the power to appoint Trustees for the Trust. Authority also retains the right to remove a Trustee upon 30 days notice to all Trustees. The Trust will not appoint an administrator, but Authority will appoint one or more investment managers, reserving the power to remove an investment manager at any time.

When the Trust terminates, its assets will first go to pay any outstanding liabilities and expenses of the Trust itself. After which, the Trust will disperse funds in accordance with Authority's retiree health plan as instructed by Authority. After Authority satisfies all liabilities to its current and former employees, and/or their beneficiaries, the balance of the funds will be distributed to Authority.

#### LAW AND ANALYSIS

Section 115(1) of the Code provides, in relevant part, that gross income "does not include income derived from any public utility or the exercise of any essential governmental function and accruing to a state or any political subdivision thereof . . . ."

Rev. Rul. 77-261, 1977-2 C.B. 45, states, "Income from a fund, established under a written declaration of trust by a State, for the temporary investment of cash balances of the State and its political subdivisions . . . is excludable from gross income . . . ." The ruling reasons that the "investment of positive cash balances . . . in order to receive some yield on the funds until needed to meet expenses is a necessary incident of the power of the State or political subdivision to collect taxes and other revenues for use in meeting governmental expenses." The ruling also explains that because the participating political subdivisions have an "unrestricted right to receive in their own right their proportionate share of the investment fund's income as it is earned, the fund's income accrues to them within the meaning of section 115(1)." The ruling makes clear that Congress did not intend to burden a State's effort to join in ventures that might accomplish projects which the sovereign is responsible to conduct.

Rev. Rul. 90-74, 1990-2 C.B. 34, provides that the "income of an organization formed, operated and funded by political subdivisions to pool their casualty risks, or other risks arising from their obligations concerning public liability, workers' compensation, or employees' health is excluded from gross income under section

115(1) of the Code.” The ruling further states that private interests may “not participate in the organization or benefit more than incidentally from the organization.”

The Trust will hold and invest contributions to fund Authority’s obligations to provide retiree medical benefits to certain retired employees of Authority, which is a joint powers authority under State Statute A. The Trust participation is expressly restricted to include only the employees of Authority. Providing retiree medical benefits to certain employees of Authority constitutes the performance of an essential governmental function. Based on Rev. Rul. 77-261 and Rev. Rul. 90-74, the Trust performs an essential governmental function under section 115(1) of the Code.

Further, in accordance with section 115(1), the Trust’s income accrues to Authority, which is a joint powers authority under State Statute A. No private interests materially participate in the Trust or benefit more than incidentally from the operation of the Trust. In the event of dissolution, all of the Trust’s remaining assets, after the payment of debts and obligations shall be distributed to Authority.

#### RULINGS

Based on the information and representations that the taxpayer has submitted under penalty of perjury, we conclude that the income of the Trust is excludable from gross income under section 115(1) of the Code.

No opinion is expressed concerning the federal tax consequences of the Trust under any other provision of the Code other than those specifically cited above. In particular, no representation is made regarding the federal tax consequences of contributions to or payments from the Plan, including (but not limited to) whether contributions to the Plan are excludable from gross income of employees, former employees or retirees under section 106 and whether payments from the Plan are excludable from gross income of employees, former employees or retirees under sections 104 or 105.

Except as otherwise provided, no opinion is expressed on the federal tax consequences of any particular transaction.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that this ruling may not be used or cited as precedent.

In accordance with a Power of Attorney on file, we are sending a copy of this letter to your representatives.

Sincerely,

Sylvia F. Hunt  
Assistant Branch Chief, Employee Organizations  
Branch 2 (Exempt Organizations/Employment  
Tax/Government Entities)  
(Tax Exempt & Government Entities)

Enclosures:

Copy of this letter

Copy for § 6110 purposes